

Slaying the Inflation Dragon

Volume 37, Issue 6 | June 6, 2022



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Investors experienced an emotional rollercoaster in May. The first three weeks of the month were fraught with negative headlines, but a relief rally ensued during the final full week of the month with the S&P 500 soaring 6.6% and the high yield bond market jumping 3.4%. The markets remain fixated on the 4 P's: Powell, Putin, Petroleum, and the Pandemic. As the twin fears of roaring inflation and rising interest rates grip the markets, the probability of a U.S. recession mounts. For the first time in modern financial history, a bear market may be foreshadowing a recession. The U.S. economy is now showing some signs of fatigue as the Federal Reserve begins to roll out its quantitative tightening policies. The execution of the Fed's \$9 trillion balance sheet unwind will be a test of the market's stability. Another test for the economy will be the Fed's ability to maintain liquidity in the face of higher interest rates, and credit markets functioning viably to prevent a recession. Clearly, corporate profitability will be adversely impacted by higher energy, labor, and commodity costs. Inflation is an insidious economic phenomenon which is difficult to tame once it filters through the entire global economy. Slaying this dragon without impeding economic activity will be a formidable challenge.